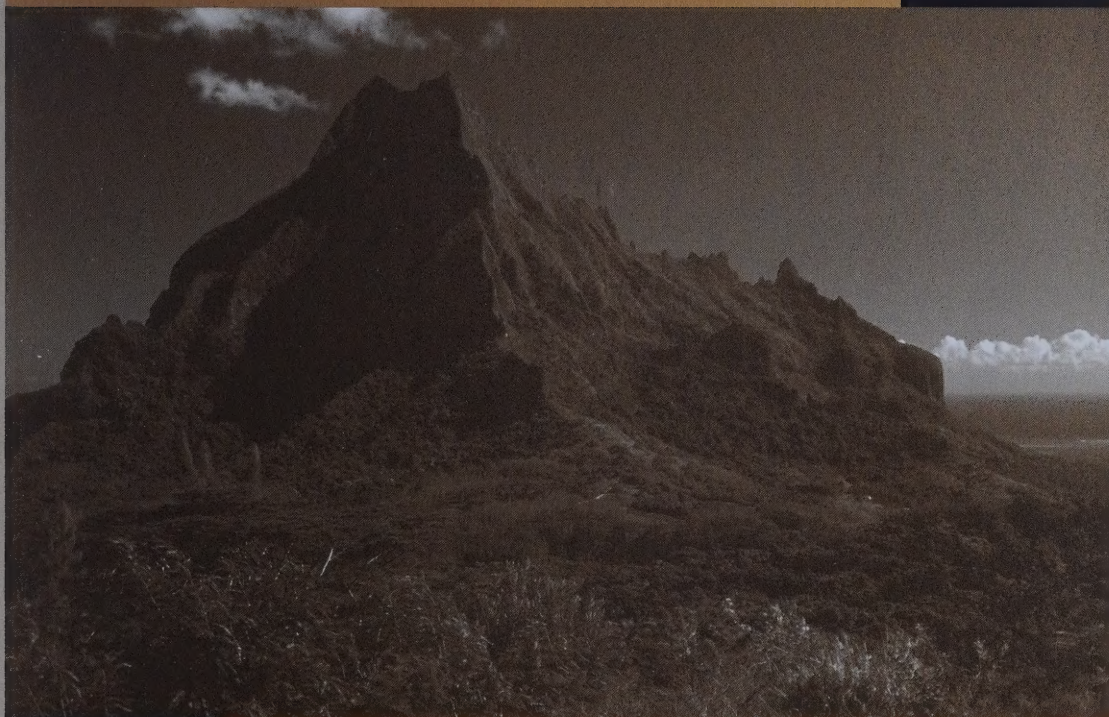


AR61

Wingspear Business Reference  
University of Alberta  
1-18 Business Building  
Edmonton, Alberta T6G 2R6

GOLD STAR ENERGY INC.



1997 ANNUAL REPORT

## CORPORATE PROFILE

Gold Star Energy Inc. is an Alberta-based oil and gas company. The company has a small existing production and reserve base in Western Canada, however, a new management team intends to redirect the focus of the company to lower cost exploitation opportunities in South America.

The corporation has signed a purchase agreement for 40% ownership in two oil producing concessions in Argentina, which is expected to close in April 1998.

Gold Star's common shares trade on The Alberta Stock Exchange under the symbol GSN.

The Annual General and Special Meeting of the shareholders will be held on Friday, May 8th, at 10:00 a.m. in the Cardium Room of the Calgary Petroleum Club Calgary, Alberta.

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## President's Report to Shareholders

For Gold Star Energy, 1997 was a year of financial restructuring and change in focus. Cashflow from operations at the beginning of the year was less than the payments required to service the corporation's debts. In order to create a positive cash position, assets were sold and a small financing was completed.

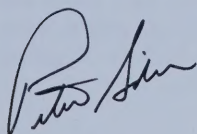
Next, a new management team was recruited to rebuild shareholder value. A private placement offering in November 1997, at market price, provided an opportunity for management to gain ownership in the corporation and supply funding to pursue new ventures. The officers and directors of Gold Star now own 23% of the outstanding shares on a fully diluted basis, and are committed to the corporation's future success.

Our strategy is to apply Canadian exploitation and exploration expertise in the less competitive basins of South America, Argentina in particular. The initial focus is on low risk exploitation opportunities to build a cashflow resource that will fund higher risk and higher reward exploratory ventures. Gold Star's new management team represents over one hundred and fifty years of combined oil and gas technical experience and expertise, along with successful track records in Canada and Argentina.

Gold Star has entered an agreement to acquire interests in two oil concessions in Argentina. At closing in April 1998, this will give the corporation a 40% working interest in a 300,000 acre concession in northern Argentina with net production exceeding 250 BOPD. A reserve evaluation by Gilbert Laustsen Jung Associates assigns more than 2.4 million barrels of proven undeveloped reserves net to Gold Star providing significant production growth potential. Gold Star continues to pursue other complimentary opportunities in Argentina and has spent \$150,000 reprocessing seismic to evaluate a farm-in on a producing oil concession. An additional \$100,000 was spent for a technical evaluation of a gas field with large proven and probable reserves, which is expected to be tendered in 1998.

Today's Canadian oil and gas industry is characterized by a large number of players competing for very limited resources, technical staff, mineral rights, and contract services. The need for corporations to demonstrate growth to shareholders in this aggressive environment forces business decisions to their economic limits, resulting in the declining performance and returns witnessed on average over the past couple of years. Gold Star is positioned to outperform its competitors by applying expertise in areas where finding and development costs provide excellent economic returns, even in today's commodity price environment.

It is with anticipation that we look forward to 1998.



Peter A. Sider  
*President and Chief Executive Officer*

March 20, 1998

## Management Team



*Gregg Vernon, Stan Grad, Peter Sider, James Judd*

### **Peter A. Sider**

Mr. Sider is the President, Chief Executive Officer, and a director of the corporation. Mr. Sider is a professional engineer and has over 19 years experience. The majority of Mr. Sider's professional career has been with Amoco Canada managing production operations in Alberta, Saskatchewan, and British Columbia. Subsequently over the last four years, Mr. Sider held various positions with Grad & Walker Energy Corporation, most recently as Vice President, Operations and Chief Operating Officer. Mr. Sider has extensive experience in production, operations, construction, drilling and completions.

### **Stan G.P. Grad**

Mr. Grad is the Chairman of the Board and a director of the corporation. Mr. Grad is a professional engineer with over 25 years experience in the oil and gas industry. Most recently, as founder of Grad & Walker Energy Corporation, where he held positions as Chairman, President and Chief Executive Officer. Mr. Grad participates actively within the petroleum industry and the community, he is a director and member on many boards and foundations including: Real Resources Inc., Interprovincial Satellite Services Ltd. (INTERSAT), and Alberta Shock Trauma Air Rescue Society (STARS). In 1997, Mr. Grad was presented with an Honorary Bachelor of Applied Technology Degree from SAIT recognizing his many contributions to the petroleum industry.

### **Gregg K. Vernon**

Mr. Vernon is the Vice President, Chief Operating Officer, and a director of the corporation. Mr. Vernon is a professional engineer and has over 20 years experience in the oil and gas industry most recently with Centurion Energy International, Inc. Previously, Mr. Vernon spent a large portion of his career with Schlumberger in both domestic and international operations. As International Coordinator, he participated in international projects relating to Canadian oil and gas companies.

### **Dr. James B. Judd**

Dr. Judd is the Vice President of Exploration for the corporation. Dr. Judd is a professional geologist with over 16 years experience in the oil and gas industry, most recently as General Manager of Centurion Oil and Gas Company, Argentina. Dr. Judd's professional background has focused primarily within the international arena. He has worked extensively in South America over the past 11 years, particularly in Argentina. He has held various positions including Manager of Exploration for Quintana Minerals Corporation, and Manager of Exploration of Dong Won Corporation.

## Areas of Focus



# Management's Discussion and Analysis

## HIGHLIGHTS

During the second quarter of 1997, the corporation sold some of its properties in Saskatchewan for \$640,000 and used these proceeds to reduce its long-term debt.

In March 1997, the corporation closed a private placement offering of 3,000,000 special warrants at a price of \$0.36 per special warrant for gross proceeds of \$1,080,000.

In November 1997, the corporation closed a private placement offering of 4,993,000 units at a price of \$0.35 per unit for gross proceeds of \$1,747,550. Up to December 31, 1997, the funds from these private placements have been used as follows:

Loans to three key Officers to purchase shares in the corporation	\$ 300,000
Capitalized expenditures related to investigating new oil and gas prospects in Argentina	\$ 360,000
Held as working capital at December 31, 1997	<u>\$2,000,000</u>
	<u>\$2,660,000</u>

## OPERATING RESULTS

During the year, revenues decreased from \$565,249 for 1996 to \$286,723 for 1997, due primarily to the disposal of certain properties in Saskatchewan. The corporation's net loss for the year was \$765,975 as compared to \$550,843 for 1996, due to this decline in revenues and an increase in general and administrative expenses.

General and administrative expenses increased from \$127,850 in 1996 to \$244,453 in 1997, due to an increase in office staff and costs related to equity financings done during the year.

## FUTURE OPERATIONS

The corporation continues to hold some domestic producing properties, but is now focusing its attention on international projects, in particular, Argentina. The corporation is planning to be fully operational in Argentina by the second quarter of 1998.

## YEAR 2000

In 1998, the corporation will proceed with a year 2000 date conversion project. This project is not expected to add significant incremental costs as the corporation does not have proprietary programs and relies on software and equipment suppliers. There is no assurance the systems of other companies on which the corporation's systems rely will be timely converted or any such failure to convert by another company would not have an adverse effect on the corporation's systems.

# Auditors' Report to the Shareholders

We have audited the balance sheets of Gold Star Energy Inc. as at December 31, 1997 and 1996 and the statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the corporation as at December 31, 1997 and 1996 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG

KPMG  
Chartered Accountants

*Calgary, Canada  
March 10, 1998*

# Balance Sheet

December 31, 1997, with comparative figures for 1996

1997

1996

## ASSETS

### Current assets:

Cash	\$ 203,549	\$ 104,136
Investments and marketable securities	1,900,000	-
Accounts receivable	42,039	240,790
	2,145,588	344,926
Petroleum and natural gas properties (note 2)	631,979	1,462,843
Other receivables (note 5)	300,000	-
	\$3,077,567	\$1,807,769

## LIABILITIES AND SHAREHOLDERS' EQUITY

### Current liabilities:

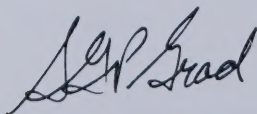
Accounts payable and accrued liabilities	\$ 226,115	\$ 404,029
Current portion of long-term debt (note 3)	324,000	300,000
	550,115	704,029
Long-term debt (note 3)	-	644,799
Provision for future abandonment and site restoration	19,400	12,400

### Shareholders' equity:

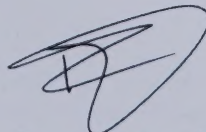
Share capital (note 4)	3,932,692	1,105,206
Deficit	(1,424,640)	(658,665)
	2,508,052	446,541
Subsequent event (note 8)		
	\$ 3,077,567	\$1,807,769

See accompanying notes to financial statements.

On behalf of the Board:



Stan Grad, Director



Raymond Antony, Director

# Statement of Operations and Deficit

Years ended December 31, 1997,  
with comparative figures for 1996

	1997	1996
Revenue:		
Oil and gas sales, net of royalties	\$ 260,849	\$ 561,015
Interest income	25,874	4,234
	<u>286,723</u>	<u>565,249</u>
Expenses:		
Operating	154,848	308,706
General and administration	244,453	127,850
Interest on long-term debt	38,950	57,137
Depletion and depreciation	614,447	622,399
	<u>1,052,698</u>	<u>1,116,092</u>
Net loss	765,975	550,843
Deficit, beginning of year	658,665	107,822
Deficit, end of year	<u>\$ 1,424,640</u>	<u>\$ 658,665</u>
Loss per share	<u>\$ 0.04</u>	<u>\$ 0.04</u>

See accompanying notes to financial statements.

# Statement of Changes in Financial Position

Years ended December 31, 1997,  
with comparative figures for 1996

	1997	1996
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (765,975)	\$ (550,843)
Items not involving cash:		
Depletion and depreciation	614,447	622,399
Net change in non-cash working capital	44,837	(20,869)
	(106,691)	50,687
Financing activities:		
Issuance of common shares for cash	3,035,550	165,050
Issuance of long-term debt	-	883,799
Share issuance costs	(208,064)	(5,698)
Repayment of long-term debt	(644,799)	(157,000)
Loan receivable	(300,000)	-
	1,882,687	886,151
Investing activities:		
Acquisitions	-	(540,000)
Disposition of petroleum and natural gas properties	716,000	33,855
Additions to petroleum and natural gas properties	(492,583)	(906,671)
Additions to investments and marketable securities	(1,900,000)	-
	(1,676,583)	(1,412,816)
Decrease (increase) in cash	99,413	(475,978)
Cash, beginning of year	104,136	580,114
Cash, end of year	\$ 203,549	\$ 104,136

See accompanying notes to financial statements.

# Notes to Financial Statements

*Years ended December 31, 1997 and 1996*

The Corporation is active in the acquisition, exploration and development of oil and natural gas properties.

## 1. SIGNIFICANT ACCOUNTING POLICIES:

(a) Petroleum and natural gas properties:

The Corporation follows the full cost method of accounting, for petroleum and natural gas properties whereby all costs relating to the acquisition, exploration and development of oil and gas reserves are capitalized. Such costs are accumulated by cost centre, being Canada and Argentina. The costs related to a cost centre from which there is production, together with costs of production and related equipment are depleted and depreciated using the unit-of-production method based on estimated gross proven petroleum and natural gas reserves as determined by independent reservoir engineers.

In applying the full cost method of accounting capitalized costs less accumulated depletion and depreciation are restricted from exceeding a net recoverable amount equal to the estimated undiscounted future net revenues, based on current prices and costs, derived from proven reserves, less the aggregate estimated future site restoration and reclamation costs, development, general and administrative, financing and income tax costs plus the lower of cost and estimated fair value of unproven properties.

The costs related to cost centres from which there has been no commercial production are not subject to depletion until commercial production commences. These capitalized costs are periodically assessed to determine whether it is likely such costs will be recovered in the future. To the extent there are costs which are unlikely to be recovered in the future, they are written off.

Substantially all exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

(b) Future abandonment and site restoration:

Estimated future abandonment and site restoration costs are provided for based on the unit-of-production method. These expenditures are charged to the accumulated provision account as incurred.

(c) Per share data:

Loss per share is calculated using the weighted average number of common shares outstanding during the year. Fully diluted loss per share is not presented as the exercise of share options and the warrants is not dilutive.

(d) Flow-through shares:

The deductions for income tax purposes of expenditures related to exploration and development activities funded by flow-through share arrangements are renounced to shareholders in accordance with income tax legislation. Oil and gas properties and share capital are reduced by the estimated value of the renounced tax deductions when the expenditures are incurred.

- (e) Investments and marketable securities:  
Investments and marketable securities are recorded at cost, which approximates market value.
- (f) Measurement uncertainty:  
The amounts recorded for depletion, depreciation and site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

## 2. PETROLEUM AND NATURAL GAS PROPERTIES:

	Cost	Accumulated depletion and depreciation	Net book value
1997			
Canada:			
Petroleum and natural gas properties	\$ 1,604,068	\$ 1,353,000	\$ 251,068
Furniture and office equipment	21,066	1,086	19,980
Argentina:			
Pre-production development costs	360,931	-	360,931
1996	\$ 1,986,065	\$ 1,354,086	\$ 631,979
Petroleum and natural gas properties	\$ 2,211,843	\$ 749,000	\$1,462,843

As a result of a ceiling test calculation, which was performed with an effective date of December 31, 1997, it was determined that the net book value of the Corporation's petroleum and natural gas properties exceeded the net recoverable amount calculated under the full cost accounting guideline and a write-down of \$449,000 was recorded as additional depletion. The ceiling test is a cost recovery test and is not intended to result in an estimate of fair market value.

## 3. LONG-TERM DEBT:

	1997	1996
\$425,000 demand bank credit facility, repayable in monthly instalments of \$25,000 plus interest at bank prime rate plus 1.5%, secured by a general assignment of book debts and a \$1,000,000 fixed and floating charge debenture over all other assets	\$ -	\$ 379,897
Subordinated convertible redeemable debentures, unsecured, bearing interest at 9% payable quarterly, with a term of 3 years, convertible at \$0.25/share and a non-call period expiring June 30, 1997	324,000	324,000
Note payable to a company controlled by a Director, bearing interest at 3% per annum unsecured with no set terms of repayment	-	240,902
	324,000	944,799
Less current portion	324,000	300,000
	\$ -	\$ 644,799

#### 4. SHARE CAPITAL:

- (a) Authorized:  
 Unlimited number of common shares, without nominal or par value  
 Unlimited number of preferred shares, without nominal or par value

(b) Issued:

	Number of shares	Amount
Balance, December 31, 1995	12,304,461	\$1,233,524
Issued for cash:		
Pursuant to private placement of flow-through shares	667,000	100,050
Exercise of options	350,000	35,000
Stock options exercised	300,000	30,000
Less: Tax effect of flow-through share funds expended	-	(287,670)
Share issuance costs	-	(5,698)
Balance, December 31, 1996	13,621,461	\$1,105,206

Issued for cash:

Pursuant to private placement	3,000,000	1,080,000
Exercise of options	200,000	25,000
Exercise of warrants for common shares	450,000	183,000
Pursuant to private placement of units	4,993,000	1,747,550
Less: Share issuance costs	-	(208,064)
Balance, December 31, 1997	22,264,461	\$3,932,692

- (c) On November 7, 1997, the Corporation entered into a private placement agreement to issue up to 4,993,000 units at a price of \$0.35 per unit. Each unit consists of one common share and one common share purchase warrant. Each whole purchase warrant entitles the holder to purchase one common share at \$0.50 per share on or before November 7, 1999.
- (d) On March 20, 1997, the Corporation entered into a private placement subscription agreement to issue up to 3,000,000 special warrants at a price of \$0.36 per special warrant. Each special warrant, upon exercise, allows the holder to receive one unit of the Corporation. Each unit consists of one common share and one half of one common share purchase warrant. Each whole purchase warrant entitles the holder to purchase one common share at \$0.50 per share on or before March 20, 1998.

As part of the placement agreement the Corporation issued 300,000 special broker units, as above, which were exercised during the year.

- (e) Pursuant to the stock option plan for its directors and officers, the Corporation has granted options to purchase 1,570,000 common shares at prices ranging from \$0.35 to \$0.45 per share, expiring on dates up to November 7, 2002. Subsequent to year end, the Corporation issued options to purchase 130,000 common shares to a director and employee with exercise prices ranging from \$0.42 to \$0.70.

## 5. RELATED PARTY TRANSACTIONS:

- (a) Loans receivable of \$300,000 owing from officers and directors of the Corporation for the purchase of shares of the Corporation from treasury. Loans bear interest at the rate of 6.5% per annum and are secured by 855,000 common shares of the Corporation.
- (b) Accounts receivable include \$nil (1996 - \$35,210) owing from companies controlled by former directors of the Corporation.
- (c) Accounts payable include \$nil (1996 - \$138,956) owing to companies controlled by former directors of the Corporation.
- (d) During 1997, the Corporation paid \$117,671 (1996 - \$35,000) for consulting services provided by companies controlled by directors and officers of the Corporation.
- (e) During 1996, the Corporation issued 667,000 flow-through shares to former directors at \$0.15 per share for total proceeds of \$100,050.

## 6. INCOME TAXES:

The provision for income taxes differs from the amounts which would be obtained by applying the expected combined federal and provincial income tax rate as follows:

	1997	1996
Income tax rate	44.6%	44.6%
Computed "expected" income tax recovery	\$ (341,625)	\$ (245,676)
Non-deductible depletion	34,515	34,231
Crown royalties	11,881	21,015
Other	598	-
Alberta Royalty Tax Credit	(1,829)	321
Resource allowance	-	(17,388)
Unrecognized benefit of losses	296,460	207,497
Provision for income taxes	\$ -	\$ -

## 7. FINANCIAL INSTRUMENTS:

The carrying values of cash, investments and marketable securities, accounts receivable and accounts payable and accrued liabilities approximate their fair value due to the relatively short periods to maturity of these instruments.

Long-term debt with fixed rates of interest has not been revalued as no market exists which could be used to establish current rates. All long-term debt with variable interest rates is assumed to already be at fair value, and therefore is not revalued.

## 8. SUBSEQUENT EVENT:

The Corporation has entered an agreement, subsequent to year end, to acquire interests in two oil concessions in Argentina for total consideration of \$2.8 million U.S. The agreement is subject to financing and a due diligence review by the Corporation and is expected to close in April 1998.

# Corporate Information

## Board of Directors

Stan G.P. Grad<sup>(1)</sup>  
Chairman of the Board  
Independent Businessman  
Airdrie, Alberta  
September 1997

Peter A. Sider  
President and Chief Executive Officer  
Gold Star Energy Inc.  
Calgary, Alberta  
September 1997

Gregg K. Vernon  
Vice President and Chief Operating Officer  
Gold Star Energy Inc.  
Calgary, Alberta  
November 1997

J. Richard Harris  
Independent Businessman  
Calgary, Alberta  
November 1997

Raymond P. Antony<sup>(1)</sup>  
Independent Businessman  
Calgary, Alberta  
January 1997

David E. Butler<sup>(1)</sup>  
President, Passport Petroleums Ltd.  
Calgary, Alberta  
February 1997

<sup>(1)</sup> Member of the Audit Committee

## Officers

Peter A. Sider  
President and Chief Executive Officer

Gregg K. Vernon  
Vice President and Chief Operating Officer

James B. Judd  
Vice President Exploration

## Head Office

910, 520 - 5 Avenue S.W.  
Calgary, Alberta T2P 3R7  
Telephone: (403) 264-7998  
Facsimile: (403) 508-2885

## Reservoir Engineers

Gilbert Laustsen Jung Associates Ltd.  
Calgary, Alberta

## Auditors

KPMG Chartered Accountants  
Calgary, Alberta

## Bankers

Royal Bank of Canada  
National Bank of Canada  
Calgary, Alberta

## Solicitors

Ogilvie and Company  
Davision Worden  
Calgary, Alberta

Maciel, Norman, Martelli & Beretta  
Buenos Aires, Argentina

## Registrar and Transfer Agent

CIBC Mellon Trust Company  
Calgary, Alberta

## Stock Exchange Listing

The Alberta Stock Exchange  
Symbol - GSN

Printed in Canada  
Produced by Graycon Group Ltd.  
Photo Credit: Julian Ferreira